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In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 539

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, a national banking association,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

Brief of California Bankers Association, Amicus Curiae, in support of Petitioner's Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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SUBJECT INDEX

	Page
Statement of Interest of the Amicus Curiae	1
Argument	2
1. The Decision of the Court of Appeals Is in Conflict with the Decision of Other Courts of Appeal on the Same Matter	2
2. The Court of Appeals Has Decided an Important Question of Federal Law Which Has Not Been, but Should Be, Settled by the Supreme Court	4
3. The Decision of the Court of Appeals Is in Conflict with Applicable Decisions of the Supreme Court	4
Conclusion	6

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By consent of petitioner, Bank of America National Trust and Savings Association, and of respondent, United States of America, filed herewith, California Bankers Association files this brief as amicus curiae.

STATEMENT OF INTEREST OF THE AMICUS CURIAE

The amicus curiae, California Bankers Association, is a nonprofit organization the membership of which includes most of the commercial banks active in the State of Cali-

fornia. In their lending operations, California banks rely upon the fact that borrowers maintain deposits with the lending bank and upon the lending bank's common law and distinctive statutory right to set off a borrower's deposit against his indebtedness. In reliance upon that right, banks in this State have for many years looked to a borrower's deposit as a form of security for their loans.

This litigation involves a determination of whether that right may be effectively nullified by a federal tax lien. If permitted to stand, the decision of the court below would cast upon lending banks the burden of a borrower's tax liability and would substantially impair the credit activities of banks in California. Accordingly, this action is of vital concern to the banking industry in this State.

ARGUMENT

1. The Decision of the Court of Appeals Is in Conflict with the Decision of Other Courts of Appeal on the Same Matter

As noted on pages 8-11 of the petition, California Code of Civil Procedure, Section 440 is almost unique in providing for the automatic extinction of cross-demands, without the necessity of a volitional exercise of a right of set-off. Even apart from such a provision, however, courts of other circuits have long upheld a creditor's right of set-off against a federal tax lien in the circumstances presented by this case.

In *United States v. Bank of Shelby,* 68 F.2d 538 (5th Cir. 1934), a federal tax lien was held subordinate to a bank's common law right of set-off against a borrower's deposit despite the fact that the Government had notified the bank of its intention to levy upon that deposit prior to the time the bank asserted its pre-existing right of off-set. The court reasoned that on the day such notice was given:

> ". . . the bank could either at law or in equity have defeated a demand by . . . [its debtor], of the money apparently to his credit by offsetting the note which produced the credit, and the United States can only claim under and through him and subject to the defenses and equities affecting him. Debts thus in origin and in equity joined together could not by lien or levy be put asunder. . . ." (68 F.2d at 540.)

Similar facts were involved in *United States v. Bank of United States,* 5 F. Supp. 942 (S.D.N.Y. 1934). In upholding the defendant bank's common law right of set-off, the court stated:

> "It would be most unfair that a third person, merely by reason of his interposition, whether he was a sovereign or not, should be able to change the rights inter sese between the obligor of the chose in action and his obligee, who is the objective of the levy or attachment." (5 F. Supp. at 945.)

The court expressly noted that the depositor had been permitted to withdraw funds from its account until the time of notice of levy, ruling that its use of the account was in the nature of a revocable license and not a property right to which the Government's lien could attach.

Later decisions in other circuits are in accord. See,

United States v. Long Island Drug Co., 115 F.2d 983 (2d Cir 1940);

Karno-Smith Co. v. Maloney, 112 F.2d 690 (3d Cir. 1940);

United States v. Guarantee Bank & Trust Co., 56 F. Supp. 470 (E.D.N.C. 1944);

Transmix Concrete of Rochdale v. United States, 142 F. Supp. 306 (W.D. Tex. 1956);

In re Halprin, 280 F.2d 407 (3d Cir. 1960);

United States v. Raley Contracting Co., 210 F. Supp. 54 (N.D. Miss. 1962).

Each of those decisions has an *a fortiori* application in jurisdictions recognizing the automatic extinction of cross-demands. The ruling of the court below is in conflict with those decisions, and that conflict should be resolved by this Court.

2. The Court of Appeals Has Decided an Important Question of Federal Law Which Has Not Been, but Should Be, Settled by the Supreme Court

This Court has never directly decided the issue presented in this case. The importance of the right of off-set to the banking community has already been noted on pages 12-13 of the petition and in the amicus curiae's Statement of Interest. That right is also basic to numerous relationships in addition to that of bank and borrower-depositor, such as that of bailor and bailee, landlord and tenant, shipper and carrier, and contractor, owner and subcontractor. In fact, it is basic to any situtation involving two or more parties with mutual monetary obligations. In view of these considerations, of the increasing number of federal tax liens being filed each year, and the uncertainty now existing in the law, it is of utmost importance that this Court resolve that issue once and for all.

3. The Decision of the Court of Appeals Is in Conflict with Applicable Decisions of the Supreme Court

Although this Court has not directly decided the question presented, it has ruled that the determination of whether the taxpayer possesses property to which a tax lien can attach must be decided in accordance with applicable state law. The court below did not decide that question in accordance with California law and its ruling is, therefore, in conflict with the rulings of this Court.

The rule that state law is controlling on the question of whether the taxpayer has any interest in property to which

a tax lien can attach has been enunciated by this Court in various contexts, commencing with its decision in *United States v. Bess,* 357 U. S. 39 (1958). In that case, the Court considered the liability of a beneficiary of an insurance policy upon the life of a deceased taxpayer against whom a tax lien existed. The Court stated that since Section 3670 of the Internal Revenue Code of 1939 [Section 6321 of the 1954 Code] "creates no property rights but merely attaches consequences, federally defined, to rights created under state law, *Fidelity & Deposit Co. v. New York City Housing Authority,* 241 F.2d 142, 144, we must first look to . . . [the taxpayer's] right in the policies as defined by state law." (357 U. S. at 55.)

In *United States v. Brosnan,* and *Bank of America N.T. & S.A. v. United States,* 363 U. S. 237 (1960), it was held that a subsequent federal tax lien could, after default on a prior mortgage or deed of trust, be divested by a judicial sale or by a private sale pursuant to the terms of the instrument. In reaching this conclusion, the Court adopted state law governing divestiture of federal tax liens as federal law, in order to avoid "severe dislocation to local property relationships." (363 U. S. at 242.) The Court also reaffirmed the rule of the *Bess* case.

That rule was again applied in *Aquilino v. United States,* 363 U. S. 509 (1960), in which a subcontractor sought to enforce a mechanic's lien and to impress a trust upon funds held by a general contractor against whose property a federal tax lien was asserted. The Court stated that the threshold question in *every* case in which the federal government asserts its tax lien is whether and to what extent the taxpayer has property to which the tax lien can attach. "In answering that question, both federal and state courts must look to state law . . ." (363 U. S. at 512.)

That principle was reaffirmed once again in the latest Supreme Court decision on this question, *United States v. Durham Lumber Co.*, 363 U. S. 522 (1960).

The court below failed to give effect to those decisions of the California Supreme Court which have construed California Code of Civil Procedure, Section 440.[1] It thereby violated the principle established by the *Bess, Brosnan, Aquilino* and *Durham Lumber* decisions.

CONCLUSION

For the foregoing reasons, it is submitted that the writ of certiorari should be granted in order to review the judgment of the court below, or in the alternative, to vacate and remand for more careful determination of the property rights of the petitioner and the taxpayer-depositor under applicable state law.

Dated: October 5, 1965.

Respectfully submitted,

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1. The lower court regarded its prior decision in *Bank of Nevada v. United States*, 251 F.2d 820 (1957), *cert. denied*, 356 U.S. 938 (1958), as controlling in this case. But the *Bank of Nevada* case arose out of transactions occurring in the State of Nevada, not California. So far as the amicus curiae can determine, Nevada law does not recognize the automatic extinction of cross-demands as provided by California Code of Civil Procedure, Section 440. In reaching its decision the court below ignored that basic difference between the law of California and Nevada.